

The Implications of Changing the Current Law on Charitable Deductions—Maintaining Incentives for Donating Art to Museums

I. INTRODUCTION

Art galleries and museums¹ are depositories for the artistic efforts that both reflect and shape different cultures and periods. Only through galleries and museums are great works of art made available to everyone regardless of age, social standing, or background.²

Since 1917, the United States has acknowledged the public benefit of gifts to museums and art galleries by providing strong incentives for them in the tax code.³ Though the majority of owners of works of art are quite wealthy, Congress, recognizing the great need and benefit of providing incentives for these owners to donate their works to museums, has given them preferential treatment in the form of tax shelters and deductions.⁴

Despite the socially desirable benefit of the charitable deduction, it has proved to be an increasingly fragile part of the tax system,⁵ particularly regarding donations of appreciated property.⁶ Recently, Congress has been closely scrutinizing deduc-

1. This Article will deal only with art galleries and museums, although the tax consequences of gifts to churches, educational institutions, hospitals, foundations, and other charitable organizations qualifying under I.R.C. § 170(b)(1)(A) and (B) are substantially similar. See generally, Sugarman, *New Incentives and Choices for Charitable Gifts to Private Foundations*, 9 REV. TAX'N IND. 219 (1985); Teitell, *TRA '84 Provisions Affecting Charities and Donors*, 123 TR. & EST. 15 (Oct. 1984); Tidd, *Impact of TRA '84 on Nonprofits*, 123 TR. & EST. 22 (Oct. 1984); Wiedenbeck, *Charitable Contributions: A Policy Perspective*, 50 MO. L. REV. 85 (1985); Wood, *Individual Charitable Deductions After the Tax Reform Act of 1984*, 9 REV. TAX'N IND. 88 (1985); Note, *Moral Obligation Financial Aid Programs: A Section 170 Analysis*, 84 COLUM. L. REV. 1402 (1984).

2. American museum collections are both rich and diverse, providing compelling evidence of the generosity of generations of donors. AMERICAN ASSOCIATION OF MUSEUMS AND ASSOCIATION OF ART MUSEUM DIRECTORS, *GIFTS OF PROPERTY: A GUIDE FOR DONORS AND MUSEUMS* 6 (1985) (available from the American Association of Museums) [hereinafter cited as AAM Guide]. In the case of the Metropolitan Museum of Art in New York, seventy to seventy-five percent of the acquisitions in the past ten years have come in the form of gifts of artistic works. Presentation by William Macomber, President, Metropolitan Museum of Art, New York, New York, Statement of the American Association of Museums to House Ways and Means Committee of the U.S. House of Representatives 3 (July 8, 1985) (available from the American Association of Museums). "In many if not most other art museums, the percentage of acquisitions received in the form of gifts of art objects is even higher than at the Metropolitan, often exceeding ninety percent." *Id.* Donors also provide museums with gifts of stocks and bonds, real estate, cash, and many other items of tangible and intangible property. Telephone interview with Ruth Hargraves, Legislative Coordinator of the American Association of Museums (Oct. 29, 1985). These gifts provide profits for upkeep and general operating support, or for endowments which build up reserves for a museum so it does not have to "live on the edge" (e.g., relying on yearly membership drives), but rather has a secure financial base. *Id.*

3. AAM Guide, *supra* note 2, at 6.

4. A "deduction" is defined as that which is taken away, deducted, or subtracted; "as deductions from gross income in arriving at net income for tax purposes." BLACK'S LAW DICTIONARY 372 (5th ed. 1979); see also J. CHOMMIE, *FEDERAL INCOME TAXATION* § 44 (2d ed. 1973).

A "tax shelter" is a device used by taxpayers to reduce or to defer payment of taxes. Common forms of tax shelters are investments where such deductions as depreciation, interest, taxes, etc., may be used to offset a taxpayer's ordinary income. See BLACK'S LAW DICTIONARY 1311 (5th ed. 1979). See *infra* notes 20, 22. See generally ARTHUR ANDERSON & CO., *TAX SHELTERS: THE BASICS* (1985); Comment, *Abusive Tax Shelters After the Tax Reform Act of 1984*, 42 WASH. & LEE L. REV. 247 (1985).

5. AAM Guide, *supra* note 2, at 6.

6. "Appreciation in value" is defined as "the increase in the market value of an asset over its value at some earlier

tions for donations of appreciated property because the potential for their abuse has become so great, especially in light of recent gross overvaluations of such property.⁷

In general, abuse of all forms of tax shelters has become more widespread.⁸ Consequently, as Congress prepared the way for a new, comprehensive tax plan, abusive tax shelters were specifically targeted.⁹ The Tax Reform Act of 1986¹⁰ calls for a repeal of many deductions in an effort to create greater fairness and equity while eradicating abuse.¹¹ The specific provisions of the Tax Reform Act are designed to generate revenue that, in effect, would "pay for" lower tax rates. While itemized deductions would be retained for charitable contributions,¹² other provisions of the Tax Reform Act will have a detrimental impact on charitable giving, affecting not only works of art, but any gift of appreciated property—the lifeblood of museums.

This Article will examine the implications of changing the prior law on charitable deductions for gifts of appreciated property, specifically voicing concern as to the serious effects changes will have upon the donation of works of art to museums. First, an examination of the unique, but often abused standing of art as an investment will reveal that in spite of existing fears of abuses regarding this tax shelter, prior law effectively combated overvaluation. Section 170 of the Internal Revenue Code ("IRC" or "Code"), the Internal Revenue Service's ("Service") Art Advisory Panels, and the increased requirements and penalties of the Tax Reform Act of 1984 work together to prevent the abusive use of art donations. Second, a study

time;" the increase in value "may be due from inflation and/or increased demand for the asset." BLACK'S LAW DICTIONARY 92 (5th ed. 1979).

7. See *infra* notes 66–115 and accompanying text.

8. The term "abusive tax shelters," as used by the Internal Revenue Service ("Service"), "refers to certain investments or transactions in which the tax benefits derived by investors go beyond those intended by the tax law." *Tax Shelters*, [Index] STAND. FED. TAX. REP. (CCH) ¶ 300.02 (1986). "Abusive tax shelters often make use of unrealistic allocations, inflated appraisals, losses in excess of an investment, mismatching of income and deductions, financing techniques that do not conform to standard commercial business practices, or the mischaracterization of the substance of the investment or transaction." *Id.* Generally, in an abusive tax shelter, the investor has risked little more than his original investment, but receives benefits greatly in excess of that investment amount. In addition,

[o]ne of the hallmarks of an abusive tax shelter is that it is marketed or sold in terms of the ratio of tax deductions that are available to each dollar invested. This ratio of tax deductions to dollars invested is usually said to be several times greater than one-to-one. The IRS takes the position that a tax shelter that advertises that it offers investors a four-to-one "write off" is indicative of its being an abusive tax shelter.

Id.

Abusive tax shelters usually involve fraudulent investments in nonexistent or grossly and intentionally overvalued assets. Unfortunately, some shelters are really nothing more than frauds. See generally, Wassenaar, *Abusive Tax Shelters: "Too Good To Be True,"* 15 TAX ADVISER 427 (1984) (suggesting that many abusive tax shelters involve fraudulent investments in nonexistent or overvalued assets).

9. In 1982 Congress enacted the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), which authorized civil penalties and injunctions against abusive tax shelter promoters. Comment, *supra* note 4, at 251.

The Tax Reform Act of 1984 specifically targeted abusive tax shelters as an important part of its reforms. The changes in requirements for establishing tax shelters include: I.R.C. § 6111 (1986), which requires tax shelter registration, and I.R.C. § 6112 (1986), which requires a tax shelter investor list. Increases in penalties include: I.R.C. § 6700 (1986), which imposes a penalty on abusive tax shelter promoters; I.R.C. § 6659 (1986), which imposes a taxpayer penalty when property overvaluation results in tax underpayment; I.R.C. § 6621(d) (1986), which requires assessment of an interest penalty on taxpayers who substantially understate tax liability; and I.R.C. § 6601 (1986), which prescribes the time period for computation of interest. Comment, *supra* note 4, at 255 n.46 (1985).

10. H.R. 3838, 99th Cong., 2d Sess. (1986); [*Tax Reform Bill of 1986 (H.R. 3838): Text of H.R. 3838 as Reported by the Conference Committee on Sept. 18, 1986—Part I*] 73 STAND. FED. TAX. REP. (CCH) (Sept. 21, 1986) [hereinafter cited as *Tax Reform Bill of 1986*].

11. SENATE FINANCE COMM., TAX REFORM ACT OF 1986, S. REP. NO. 313, 99th Cong., 2d Sess. 3–8 (1986).

12. *Id.*

of the relevant provisions of the Tax Reform Act of 1986 will show that changing the treatment of the charitable deduction will have a detrimental impact on museums and charitable giving. Allowing the expiration of the charitable deduction for nonitemizers and a revision of the alternate minimum tax to include gifts of appreciated property will decrease the incentive to give. Although any tax reform proposal would seek to restore equality and maintain confidence in its ability to prevent abuses, any proposal concerning the charitable deduction should have first been weighed carefully in order to maintain incentives for making works of art available to the public. If the true importance of museums in each society and to every culture is recognized, then prior law should have been maintained.

II. THE UNIQUE, BUT ABUSED STANDING OF ART AS AN INVESTMENT: CURRENT LAW AND COMBATING OVERVALUATION

Leonard D. DuBoff (teacher, writer, and lecturer on all aspects of law and the visual arts)¹³ accurately states the curious nature of art as an investment:

Throughout the centuries, the wealthy have always collected works of art. Their acquisitions were not made for investment purposes, although art had long been recognized as an internationally valuable asset. The art was purchased primarily for enjoyment, with an underlying acknowledgment that it could be exchanged or "traded up" as the buyer's wealth increased. The origin of the concept of art as an investment was greeted with great controversy; but it is safe to say that today investing in art has achieved the status of respectability.¹⁴

Aside from the purely aesthetic pleasure derived from looking at a painting or sculpture, works of art are now attractive as investments. There appears to be a widespread belief that art is more valuable than money or stocks and that art prices are more stable than those of stocks or bonds.¹⁵ "Art is one of the least-vulnerable markets," notes an executive vice president of the famous art auction house, Sotheby-Parke Bernet.¹⁶ "It [the art market] is one of the last to slide and one of the first to bounce back."¹⁷ For example, the best hedge against inflation in 1975 was French Impressionist paintings—they rose 230 percent, while the Dow Jones averaged only a thirty-eight percent increase.¹⁸ And, as the media found in discussing Picasso's estate, "Here is staggeringly vulgar proof of what sophisticated businessmen have known for years: The best capital investment is not South African gold or Canadian wheat or Bolivian tin but art."¹⁹

13. Leonard D. DuBoff is the editor of *LAW AND THE VISUAL ARTS* (1974), *ART LAW: DOMESTIC AND INTERNATIONAL* (1975), and *ART LAW IN A NUTSHELL* (1984), and has written many law journal articles as well as *THE DESKBOOK OF ART LAW* (1977), which is most pertinent to this Article.

14. L. DuBoff, *THE DESKBOOK OF ART LAW* 361 (1977).

15. *Id.*

16. *Id.* at 363.

17. *Id.*

18. *Id.* at 364.

19. Maddocks, *Picasso and the Midas Touch*, *The Christian Science Monitor*, Dec. 22, 1975, at 26, col. 3; reprinted in L. DuBoff, *supra* note 14, at 364.

Some of the returns on investments in art are indeed staggering. Art collection seemingly became a near mania in the late 1970's and 1980, and prices inflated so much that from January, 1980 through the spring of 1981 there were 24

Over the years, art has become increasingly attractive as an investment, as the art market seems to consistently exceed expectations in returns to investors. Investments are often used as tax shelters to offset other income. Charitable deductions are not traditionally regarded as tax shelters. However, due to the large amounts of money typically involved in purchasing works of art and the great benefit gained in donating a work of art, investment in art is increasingly viewed as another tax shelter.

A. Art as a Tax Shelter?

Congress adopted provisions to foster tax shelter investments²⁰ in the belief that such provisions would advance a national purpose—encouragement of “investment in those sectors of the economy that needed additional capital to achieve certain economic and social (and perhaps political) objectives.”²¹ Those investors “who are willing to commit risk capital to those investments our lawmakers have sought to encourage are granted certain tax advantages,” in the form of immediate deduction of certain costs, rapid recovery of others, or tax credits.²²

Because Congress wished to encourage charity and voluntarism in addition to the cultivation of art as an important facet of society, gifts to charitable organizations were given preferential treatment. Investment in art (directly or indirectly, by donating cash and property to museums)²³ serves such a desired end. Even though charitable giving does not fall under the traditional definition or list of tax shelters,²⁴ it has unquestionably been afforded similar preferential treatment in recent years.

Tax shelters are investments that provide tax benefits to offset taxable income from other sources.²⁵ More abstractly, “a tax shelter investment is an outlay of funds at risk to acquire something of value, with the expectation that its holding will produce income and reduce or defer taxes, and that its ultimate disposition will result

paintings sold at auctions in the United States for well over \$1 million. Janata, *Appraisals—Use to Determine Fair Market Value in Tax-Oriented Partnerships and Other Transactions*, 43 N.Y.U. INST. ON FED. TAX’N § 57.21 (1985). In the fall of 1979, “Icebergs,” by Frederic Church, sold for \$2.5 million; in September, 1980, the Whitney Museum of American Art paid \$1 million for Jasper John’s “Three Flags” (“Three Flags” was originally purchased for \$900 in 1959). Thirty-six of Picasso’s “Avignon” paintings, regarded by some critics as undistinguished, sell for \$200,000 to \$400,000 each; Andy Warhol’s “Marilyn Monroe Diptych” was purchased by the Tate Gallery in London for \$300,000 in 1980. The list grows every day, as more and more works become available. *Id.*

20. See *supra* note 4. Tax shelters have enjoyed great popularity for a number of years, and have recently experienced even more growth and variation. These tax breaks encourage savings, support state and local financing, and foster economic growth. A list of some of the most frequently used tax shelters includes: Individual Retirement Accounts (IRA’s), real estate, oil and gas, equipment leasing, farming, timber, motion pictures, research and development, paintings, video recordings, securities and commodities, bonds (government, municipal, corporate, industrial development), breeding stock, charitable donations, and foreign and various other types of investments. See ARTHUR ANDERSON & Co., *supra* note 4; Janata, *supra* note 19, at § 57.1–2.

21. ARTHUR ANDERSON & Co., *supra* note 4, at 1.

22. *Id.*; More specifically, the economic incentives behind the breaks include deferral of ordinary income for several years until the taxpayer is in a lower bracket, providing tax-free income, reduction of tax liability to capital gains which are taxed at only 40 percent of the rate of ordinary income, tax deductions for depreciation and depletion, and the generation of tax losses or tax credits that can be used to offset income from other sources.

Janata, *supra* note 19, at § 57.1.

23. See *supra* note 2; Wiedenbeck, *supra* note 1, at 136.

24. See *supra* note 20.

25. Comment, *supra* note 4, at 247.

in the realization of gain.”²⁶ The realization of gain usually results in the imposition of tax.²⁷ On the other hand, donations of works of art and other gifts of appreciated property to charitable organizations have always evoked an extraordinary benefit—a donor could deduct the full fair market value of a gift without realizing gain upon the making of the gift.²⁸ The deduction induced the public to support charitable organizations. Thus, the decision to make a gift to a charity was not hindered, but was prompted by tax considerations.²⁹ A donor did not have to worry about paying taxes upon the donation of an art object—because a donor could deduct the fair market value of his or her gift, he or she would be willing to give more. Yet, the availability and amount of the deduction depends upon the characterization of the donated property under current law.

B. Current Law—Section 170

Internal Revenue Code section 170 governs the income tax consequences of gifts or contributions made by individuals.³⁰ “A contribution, for the purposes of section 170 of the Code, is a voluntary transfer of money or property that is made with no expectation of procuring a financial benefit commensurate with the amount of the transfer—it must be a gift.”³¹

Two sets of statutory provisions are used in calculating the charitable contribution deduction available to individuals: “first, those provisions which determine the portion of the contribution which is deductible, and second, those provisions which prescribe the percentage limitations on the donor’s ability to use the available deduction.”³² Contributions of cash are deductible for the full amount. However, the value of contributions of appreciated property (for example, stocks, bonds, real estate, or art objects) may be subject to a reduction, depending upon several factors.³³ What portion of a charitable contribution is deductible depends upon the length of time the property was held (at least if donated in 1986 prior to the effective date of the new law), the type of property donated, the nature of the donee, and the use to which the property was put.³⁴

Prior to the adoption of the Tax Reform Act of 1986, the length of time property was held determined whether it qualified as ordinary income or capital gain property. In most cases, a work of art was capital gain property for the purpose of computing the charitable deduction.³⁵ However, works of art could constitute either capital gain

26. See *supra* note 4; ARTHUR ANDERSON & Co., *supra* note 4, at 5.

27. I.R.C. §§ 61(a)(3), 1001(c) (1986).

28. I.R.C. § 170(a)(1) (1986); Treas. Reg. § 1.170A-1(c) (1985).

29. Wiedenbeck, *supra* note 1, at 92-95.

30. Korman, *Maximizing the Charitable Contribution Deduction: A Survey of Charitable Giving Techniques*, 43 N.Y.U. INST. ON FED. TAX’N 21.1-3 (1985); I.R.C. § 170 (1986).

31. J. FREELAND, S. LIND & R. STEPHENS, *FUNDAMENTALS OF FEDERAL INCOME TAXATION* 850 (5th ed. 1985). To be a gift for section 170 purposes there must be, among other requirements, a payment of money or transfer of property without adequate consideration. *Id.* at 854.

32. Korman, *supra* note 30, at 21.4.

33. *Id.*; I.R.C. § 170(c) (1986).

34. I.R.C. § 170(e) (1986); Korman, *supra* note 30, at 21.4.

35. I.R.C. § 170 (b)(1)(A) and (B) (1986); F. FELDMAN & S. WEIL, *ART WORKS: LAW, POLICY, PRACTICE* 789 (1974). The term “capital gain property” is defined as any capital asset, the sale of which at its fair market value at the time of

or ordinary income property³⁶ in the hands of a collector. If disposition of the property would have resulted in the recognition of long-term capital gain³⁷ to the collector, then that property was capital gain property.³⁸ Generally, unless the property constituted inventory of a dealer, had not been held for the required time under the Code (six months), or had not appreciated in value, the property was capital gain property.³⁹ It was most important to the collector desiring a deduction for a charitable contribution that the property be characterized as capital gain property rather than ordinary income property.⁴⁰ If the property was treated as ordinary income property, the amount which was deductible to the collector was reduced by the amount of gain which would have been ordinary income had the property been otherwise disposed of.⁴¹ In other words, the amount of the charitable deduction for a contribution of a work of art which is ordinary income property is limited to the basis of such property, which would be the cost of materials in the hands of the donor.

On the other hand, under prior law, when an individual taxpayer donated to a museum a capital asset that had increased in value after a holding period of six months or more and then took a deduction based upon the full fair market value of property, the capital gain that would have been realized had this appreciated property (art, stocks, real estate, etc.) been sold just disappeared,⁴² as the donor deducted his basis *plus* the amount of the appreciation. Congress has traditionally believed that the public derives a sufficient benefit to warrant such special treatment.⁴³

Under the Tax Reform Act of 1986, if an individual taxpayer donates appreciated property in 1986 that would have produced long-term capital gain if sold, then the taxpayer can deduct the property's full fair market value in 1986; no tax must be paid on the gain.⁴⁴ However, after 1986, the Tax Reform Act requires consideration of this untaxed portion—the amount of appreciation over the basis—as a tax preference item for purposes of the alternative minimum tax.⁴⁵

the contribution would have resulted in long-term capital gain. I.R.C. §§ 170 (b)(1)(c)(iv), 1221 (1986); Treas. Reg. § 1.170A-4(b)(2) (1985).

36. "Ordinary income property" includes property held by the donor primarily for sale to customers in the ordinary course of his trade or business; a work of art created by the donor; a capital asset held by the donor for less than one year; and certain stock, to the extent that gain upon its disposition would not have been long-term capital gain. Treas. Reg. § 1.170A-4(b)(1) (1985).

37. The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than six months, if and to the extent that such a gain is taken into account in computing gross income. I.R.C. § 1222(3) (1986).

38. See *supra* note 35.

39. R. DUFFY, ART LAW: REPRESENTING ARTISTS, DEALERS AND COLLECTORS 437 (1977).

40. *Id.*

41. *Id.*

42. Address by Bruce R. Hopkins (counsel for various nonprofit organizations), Implications of Proposed Tax Reform on Charitable Giving, American Association of Museums 1985 Annual Meeting (June 12, 1985) [hereinafter cited as Address by Bruce R. Hopkins].

43. L. DuBOFF, *supra* note 14, at 652.

44. PRENTICE-HALL'S EXPLANATION OF THE TAX REFORM ACT OF 1986 12 (1986).

45. *Id.* In its report on the new tax reform bill, the Senate Finance Committee states "that as a result of the bill's reduction of individual tax rates on such forms of capital income as business profits, interest, dividends, and short-term capital gains, the need to provide a reduced rate for net capital gain is eliminated." SENATE FINANCE COMM., TAX REFORM ACT OF 1986, S. REP. NO. 313, 99th Cong., 2d Sess. 169 (1986). The committee believes that the repeal of the net capital gain deduction for individuals "will result in a tremendous amount of simplification for many taxpayers since their tax will no longer depend upon the characterization of income as ordinary or capital gain." *Id.* Furthermore, capital assets will not have to be held for six months in order to obtain favorable treatment. *Id.* Based upon these factors, the committee

The reason why an object was acquired also determines its tax treatment. The item could be for personal enjoyment, investment, or for display as a part of a trade or business. IRC section 262 states that no deduction is allowed for personal expenses.⁴⁶ If, however, the acquisition was for investment purposes and the purchaser then donated the work to a charity after it met the long-term capital gain requirements, he clearly could deduct its fair market value.⁴⁷ Alternatively, the purchaser could place the work of art in his place of business and attempt to deduct its cost as an ordinary and necessary business expense.⁴⁸ If there was any question whether the display of a painting was part of a trade or business, the purchaser could immediately donate the work to a charity and take the deduction provided under section 170. Since it is difficult in some cases to determine the object's use, the purchaser may simply choose the use that gives the most favorable tax treatment.⁴⁹ Therefore, it is relatively easy for purchasers to take advantage of the tax treatment of art objects.⁵⁰

The amount of a charitable deduction also depends upon the type of property donated, the applicable percentage limitation, and the nature of the donee. Fifty-percent property constitutes gifts made during the taxable year to any publicly supported organization as described in IRC section 170(b)(1)(A)—a church, educational organization, hospital, charitable organization, or qualifying private foundation.⁵¹ The full fair market value of gifts to these organizations is deductible up to fifty percent of the taxpayer's contribution base.⁵² The contribution base is the taxpayer's adjusted gross income, computed without regard to any net operating loss carryback to the taxable year.⁵³ Gifts of thirty-percent capital gain property (under section 170(b)(1)(B), a gift to any charitable organization other than one to which subparagraph (A) applies) are generally deductible for the full fair market value of the property valued on the date of contribution if the gift is made to a qualified public charity or certain types of private foundations.⁵⁴ The exception to this rule is found in section 170(e).⁵⁵ Section 170(e) capital gain property is property contributed to or for the use of a private foundation or charitable organization which is put to an unrelated use by the donee, or which is thirty-percent capital gain property for which the donor has made an election under section 170(b)(1)(C)(iii).⁵⁶

foresees a greater willingness on the part of taxpayers to invest in freely traded assets (e.g., stock). *Id.* However, the Senate Finance Committee has failed to acknowledge the detrimental impact this provision inevitably will have on donations to museums. The harm to museums and related charities from the failure to continue giving capital gain status to gifts of art objects and other property to museums (as is still granted for gifts to certain charities and private foundations) will be far greater than the instances of abuse that are cured. *Id.* See notes 173-183 and accompanying text.

46. I.R.C. § 262 (1986).

47. See *supra* notes 28-42 and accompanying text.

48. I.R.C. § 162(a), (b) (1986) (he could not take the deduction twice).

49. Speiller, *The Favored Treatment of Purchasers of Art*, 80 COLUM. L. REV. 214, 251 (1980).

50. *Id.*

51. I.R.C. § 170(b)(1)(A) (1986).

52. *Id.*

53. I.R.C. § 170(b)(1)(E) (1986).

54. I.R.C. § 170(b)(1)(C)(iv) (1986); Treas. Reg. § 1.170A-1(e)(1) (1982).

55. I.R.C. § 170(e) (1986). See Korman, *supra* note 30, at 21.5.

56. Korman, *supra* note 30, at 21.5. According to the Statement of the Conference Committee on the Tax Reform Act of 1986:

The "related use rule" set forth in section 170(e) requires that the use of such property by the donee organization be related to the purpose or function constituting the basis for the donee's exemption under section 501.⁵⁷ If such use is unrelated to the purpose or function constituting the basis for the donee's exemption, then the amount of the charitable deduction must be reduced by forty percent of the appreciation in value of the property.⁵⁸

Two examples illustrate the related use rule. If a donor contributes a painting to an art museum (a fifty-percent organization under the IRC section 170(b)(1)(A) definition) and the museum publicly and prominently displays the painting, the contribution of the painting is deductible to the extent of the fair market value of the property. If, however, the donor contributes the painting to the Red Cross (also a fifty-percent organization) and the Red Cross sells the painting and applies the proceeds of the sale for its exempt purposes, the painting would have been put to an unrelated use, and the deduction must be reduced by forty percent of the appreciation in value with the balance deductible within the fifty-percent limitation.⁵⁹

There are drawbacks to investments in art, just as with any other form of property—be it real estate or securities. No investment is without risk, and an investment in art is really no exception. "Attorneys are not usually consulted by collectors at the time of purchase, although such consultation may increase as art values appreciate and the art forgery problem and other considerations become known by the public."⁶⁰ "[An] art investor must have a profound knowledge of his business in order to succeed," as with any other investment.⁶¹ "Profits from sizeable investments generally fall only to the art expert."⁶² "The prudent collector should purchase only from reputable dealers, obtaining a certificate of authenticity as well as a detailed receipt or bill of sale for his records."⁶³ In addition, it is difficult to buy or sell on short notice—a year is usually needed to sustain a sufficient increase in value for the buyer to obtain a return on his initial investment. Therefore, in the case of low to moderately priced works of art, dealers usually resell for between twenty to one hundred percent above their cost.⁶⁴ An individual who donated a work of art after holding it for at least six months would have the benefit of a deduction for a

No change is made to the reduction rule in section 170(e)(1)(A) for contributions of ordinary-income property or to the exception to the reduction rule in section 170(e)(5) for contributions of qualified appreciated stock to certain private foundations. Under the Senate amendment (as under present law), the amount of charitable deduction allowable to an itemizer for a donation of stock to a public charity equals (for regular tax purposes) the full fair market value of the stock at the time of the donation if the donor has held the stock for more than six months, or the donor's basis in the stock if the donor has not held the stock for more than six months (Code section 170(e)).

[*Tax Reform Bill of 1986 (H.R. 3838): Statement of the Managers* filed Sept. 18, 1986—Part II] 73 *STAND. FED. TAX REP. (CCH)* II-105, n.1 (Sept. 21, 1986).

57. I.R.C. §§ 170(e)(1)(B)(i), 501 (1986); F. FELDMAN & S. WEIL, *ART WORKS: LAW, POLICY, PRACTICE* 792 (1974).

58. I.R.C. § 170(e)(1)(B) (1986); Treas. Reg. § 1.170A-4(b)(3) (1985); F. FELDMAN & S. WEIL, *ART WORKS: LAW, POLICY, PRACTICE* 792 (1974).

59. F. FELDMAN & S. WEIL, *ART WORKS: LAW, POLICY, PRACTICE* 792 (1974).

60. R. DUFFY, *supra* note 39, at 410.

61. L. DuBOFF, *supra* note 14, at 365.

62. *Id.*

63. R. DUFFY, *supra* note 39, at 410.

64. L. DuBOFF, *supra* note 14, at 365.

substantial amount of increase in value under the fair market value which would have been ordinary gain and part of gross income had he sold the work—the reward is apparently well worth the risk.

Therefore, as the law now stands, if a donor meets the requirements of qualifying his gift as long-term capital gain property (for the 1986 tax year) and of donating it to an appropriate organization (only a qualified public charity or private foundation, to get “capital gain” treatment after 1986) which will put it to an appropriate use, he can deduct the fair market value of his gift without being taxed on any part of the amount. However, under the new law, even though a donor can still deduct the full fair market value of his gift, he will be taxed on that portion of the deduction that represents the appreciation in value.⁶⁵ But a precise determination of an art object’s value is still essential, and is often quite difficult, leaving open an area for potential abuse.

C. Potential Problems with Prior Law—Appraisals and Valuation

The favored tax treatment purchasers of art enjoy is linked to two unique characteristics of art objects. First, it is difficult to value an art object for tax purposes: “a purchaser can overvalue items donated to charities, thereby receiving excessive income tax deductions, and . . . undervalue gifts to family members, thereby avoiding transfer taxes.”⁶⁶ Second, it can be difficult to determine why an object was acquired, which is essential to a determination of its tax treatment.⁶⁷ Because such a potential for abuse exists in any case requiring valuation of property, Congress targeted transactions involving such property in the Tax Reform Act of 1986, which now imposes a tax on that portion of the deduction that represents the appreciation in the value of the property.

The determination of the fair market value of artistic property may have substantial ramifications in determining the taxes that will be paid. This determination has always been at the root of the difficulties with the fair market deduction for all gifts of appreciated capital gain property.⁶⁸ A collector who makes a charitable gift of an art object and who intends to deduct the value of that gift for income tax purposes must therefore be prepared to determine and substantiate the fair market value of the gift as of the date of transfer.

According to Treasury Regulation section 1.170A-1(c)(2), if a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution. “The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.”⁶⁹ “Fair market value may vary with

65. See note 158 and accompanying text.

66. Speiller, *supra* note 49, at 214.

67. See *supra* notes 46–50 and accompanying text.

68. I.R.C. § 170(e)(1) (1986); Treas. Reg. § 1.170A-4(a) (1985); F. FELDMAN & S. WEIL, *ART WORKS: LAW, POLICY, PRACTICE* 782 (1974); Anthoine, *Deductions for Charitable Contributions of Appreciated Property—The Art World*, 35 *TAX L. REV.* 239 (1984).

69. Treas. Reg. § 1.170A-1(c)(2) (1985).

respect to the same or similar property, depending upon the market in which the property might be sold.”⁷⁰ As the Tax Court pointed out in *Daniel S. McGuire*,⁷¹ questions often arise as to whether the dealer’s “retail” market or the auction market (a retail or wholesale market or both) should be used.⁷² On charitable gifts, the collector would normally want to choose the higher dealer market so he could deduct a larger amount, whereas for estate and gift tax purposes, the typically lower “auction” market would be preferred, reducing the amount on which he would pay taxes.⁷³

The burden of proving the value of a donated work is on the collector.⁷⁴ Since it is usually quite difficult to determine the value of an art work, especially when that work is unique, an expert appraisal should be obtained.⁷⁵ Since 1984, any gift or gifts worth more than \$5,000 to one or more charitable organizations requires an expert appraisal.⁷⁶ Increasingly, the Service began scrutinizing charitable gifts of art quite closely because of the possibility of overvaluation through fraudulent or collusive appraisals.⁷⁷ Although few cases exist which involve works of art, a handful stress the importance of obtaining an appraisal “from an expert whose qualifications will be difficult to challenge.”⁷⁸

In *Farber v. Commissioner*,⁷⁹ the Tax Court reduced the value of a gift made to a museum of a painting claimed to be by Tintoretto from \$150,000 to \$10,000 because the taxpayer’s expert did not “inspire the confidence of the court.”⁸⁰ The Service’s expert in *Posner v. Commissioner*⁸¹ valued a painting at one-tenth of the value placed upon it by the taxpayer’s expert, an art dealer of considerable knowledge and reputation in the field involved (Italian Baroque) who was also president of the Art Dealers’ Association of America. Because another painting by the same artist achieved a much lower price at an auction, the Service reduced the appraised value by two-thirds.⁸² The court rejected two commonly used methods of valuing a painting in *Cukor v. Commissioner*,⁸³ especially because one of the taxpayer’s expert witnesses used “an element of his own subjectivity or emotional reaction.”⁸⁴ And in *Samuel Silverman*,⁸⁵ the court had no confidence in the valuations of the taxpayer’s

70. R. DUFFY, *supra* note 39, at 432.

71. 44 T.C. 801 (1965).

72. *Id.* at 812.

73. *Id.* But see *Estate of David Smith*, 57 T.C. 650, 655, 658 (1972) (the court used the “retail” market evaluation—which it believed encompassed the auction method of disposal—to reduce respondent’s fair market value appraisal of sculpture at the time of Smith’s death from \$4,284,000 to \$2,700,000); Meltzer, *infra* note 100.

74. Temp. Treas. Reg. § 1.170A-13T(c)(2) (1984), *reprinted in* Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 691 (1984).

75. *Id.*; R. DUFFY, *supra* note 39, at 433.

76. Temp. Treas. Reg. § 1.170A-13T(c)(2) (1984), *reprinted in* Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 691 (1984).

77. R. DUFFY, *supra* note 39, at 433.

78. *Id.*

79. 33 T.C.M. 673 (1974).

80. *Id.*

81. 35 T.C.M. 943 (1976).

82. *Id.* at 945.

83. 27 T.C.M. 89 (1968).

84. *Id.* at 94.

85. 27 T.C.M. 1066 (1968).

expert because he impressed the court as “a cynical person with flexible scruples.”⁸⁶ As these cases show, it is difficult to establish a fair market value for works of art. Recognizing the problem of subjectivity in the valuation of artistic works and a possible tendency for collusive behavior, the Service reacted by creating a system for obtaining fair, objective appraisals.

D. Resolution of Prior Law's Problems

As increasing numbers of investors realized the benefits of purchasing art, the Service's fears of overvaluation skyrocketed. An investment through which a taxpayer could deduct the full fair market value of a gift and never be taxed on any amount of gain proved attractive to many. Purchasers knew that unless they were unlucky enough to have their tax returns audited, no mechanism existed that could test the appraisals that they had obtained. For these very reasons, the Service and Congress respectively created systems for review and control of gifts to charitable organizations.

1. The Art Advisory Panel

On February 1, 1968, the Service created the Art Advisory Panel in response to fraudulent, subjective, and inaccurate appraisals.⁸⁷ According to a Service news release,⁸⁸ the Panel's function was to help the Service determine whether appraisals placing a fair market value greater than \$20,000 on works of art donated to museums or charities were truly realistic. The creation of an advisory panel had been suggested earlier by the Association of Art Museum Directors.⁸⁹ The twelve members of the Panel represent museums, universities, and dealers; they help the Service “curb the tendency of [some] taxpayers to inflate the value of art works for tax purposes.”⁹⁰ As then IRS Commissioner Sheldon S. Cohen stated at the formation of the Panel, “In the art field there are no daily stock quotations or assessment figures we can rely on to check the accuracy of a taxpayer's valuation of his charitable gift. For this reason, we welcome the interest and cooperation leaders in the art world have shown.”⁹¹

At the outset, the Panel was concerned only with paintings, sculpture, and decorative arts. However, the Service recently expanded the original concept to create a second advisory panel—the Art Print Advisory Panel.⁹² The original Art Advisory Panel was also recently expanded from twelve to twenty-two members, adding art dealers, art history scholars, and museum directors and curators expert in

86. *Id.* at 1073.

87. IRS News Release, Feb. 1, 1968 reprinted in F. FELDMAN & S. WEIL, *LEGAL AND BUSINESS PROBLEMS OF ARTISTS, ART GALLERIES, AND MUSEUMS* 71, 73 (1973); ANNUAL REPORT OF THE COMMISSIONER OF INTERNAL REVENUE 21, 65 (1969). See generally, *IRS Cracks Down on Appraisal Abuses*, 83 ART NEWS 21 (Dec. 1984).

88. See IRS News Release, *supra* note 87.

89. F. FELDMAN & S. WEIL, *LEGAL AND BUSINESS PROBLEMS OF ARTISTS, ART GALLERIES, AND MUSEUMS* 73 (1973).

90. *Id.*

91. F. FELDMAN & S. WEIL, *ART WORKS: LAW, POLICY, PRACTICE* 839 (1974).

92. Hasson, *Gifts to Museums: Valuations*, AMERICAN LAW INSTITUTE—AMERICAN BAR ASSOCIATION COURSE OF STUDY, *LEGAL PROBLEMS OF MUSEUM ADMINISTRATION* 263 (1984).

pre-Columbian, primitive, Far Eastern and Asian Art.⁹³ Plus, the Panel is broadening its scope in terms of art objects, as evidenced by a Service news release from June, 1983, in which the Service "issued a public warning to taxpayers who contribute gems, lithographs, and similar property that the value is often no more than the original cost and that penalties may be levied against taxpayers claiming artificially inflated values."⁹⁴

Aside from some initial excitement generated by the creation of the Panel, its record of curing abuses remains strong. For example, the Annual Report of the Commissioner for 1973 stated that the Panel had been "very successful" in correcting abusive appraisals.⁹⁵ The 1982 results echo the Panel's active role in combating overvaluation: the Panel reviewed 198 cases involving 727 items of art work with claimed value of almost \$84 million, recommending acceptance of fifty-six percent of the appraisals and adjustments to thirty-seven percent.⁹⁶ A net reduction of deduction claims by eleven percent was recommended, as was a twenty-eight percent increase in gift and estate tax appraisals.⁹⁷

Thus, criticisms aimed at the deduction for the charitable donation should not be based on abuses in valuation attributable to inflated appraisals; the Service began taking steps to combat abuse in 1968 with the creation of the Art Advisory Panel, and through the years has continued to ensure more accurate appraisals of art works. Despite the efficiency of the Panel, however, Congress also recognized the need to curtail the number of abusive appraisals taking place in the art world and other related areas requiring valuations of property. Therefore, in one of the early signals of future comprehensive tax reform, Congress created strict requirements for appraisers and appraisals, and stiff penalties for violations.

2. Tax Reform Act of 1984

In an attempt to end instances of gross overvaluations of donations to charitable organizations, Congress in 1984 enacted a number of changes in the law. These changes include increases both in the substantiation requirements for gifts of property and in the penalties for overstatements of value.⁹⁸ The changes are part of the Tax Reform Act (or Deficit Reduction Act) of 1984 and pertain to certain kinds of donations made to all non-profit charitable organizations after December 31, 1984.

The specifics of section 155 of the Act are quite clear and precise, stating the requirements for all future appraisals and the strict penalties imposed if the provisions are not followed. As indicated in the American Association of Museums' *Guide for Donors*, "[t]he purpose of the requirements is to assure that values are as accurate as possible and to encourage donors and appraisers to act in good faith in seeking and

93. *Id.* at 264.

94. *Id.*

95. F. FELDMAN & S. WEIL, *ART WORKS: LAW, POLICY, PRACTICE* 839 (1974).

96. Hasson, *supra* note 92.

97. *Id.* See also Janata, *supra* note 19, at § 57.17.

98. See *supra* note 9; Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 155, 98 Stat. 691-95, (1984); AAM *GUIDE*, *supra* note 2, at 7.

supplying this substantiation.”⁹⁹ In order to obtain a charitable deduction, donors who contribute either an item or a group of similar items worth more than \$5,000 to one or more charitable organizations are required by law to obtain a qualified appraisal,¹⁰⁰ executed by a qualified appraiser,¹⁰¹ and to attach a summary of the appraisal¹⁰² to the tax return for the year in which the deduction is first claimed.¹⁰³

Because the law defines a qualified appraisal and a qualified appraiser in such precise terms, the key to a successful valuation seems to rest upon the quality of the appraisal and the appraiser. As pointed out in section 155's legislative history, a taxpayer who acquired a painting from an art dealer could not use an appraisal from that dealer, persons regularly employed by that dealer, or related persons—the appraiser must be totally independent.¹⁰⁴ Certainly, “[t]he most critical decision a donor will make in the process of obtaining a charitable deduction for a donation . . . is the selection of a qualified appraiser.”¹⁰⁵ Appraisals for which all or part of the fee paid for such appraisal is based on a percentage of the appraised value of the property shall not be treated as qualified appraisals.¹⁰⁶ In addition to independence, an appraiser's qualifications and integrity are key to whether a donor receives a deduction for his gift. Therefore, the appraisals must come from qualified and reputable sources.

The appraisal itself must include a statement of facts, essential in the valuation of a work of art, upon which the appraisal is based, listing

- (1) sales of other works by the same artist on or around the valuation date;

99. AAM Guide, *supra* note 2, at 8.

100. A “qualified appraisal” is defined under part four of section 155, and means an appraisal prepared by a qualified appraiser which includes: a description of the property, the fair market value on the date of contribution and the basis for the valuation, a statement that the appraisal was prepared for income tax purposes, the qualifications of the qualified appraiser, the signature and taxpayer identification number of the appraiser, and any additional information requested by the Secretary. Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 155, 98 Stat. 692 (1984); *See generally* address by Donald R. Speiller (general counsel to Los Angeles County Museum of Art), The 1984 Tax Act: Its Ramifications and Requirements for Museums, American Association of Museums 1985 Annual Meeting (June 11, 1985) [hereinafter cited as Address by Donald R. Speiller]; Address by Richard DeVino (attorney advisor, Office of Legislative Counsel of the U.S. Treasury Dept.), The 1984 Tax Act: Its Ramifications and Requirements for Museums, American Association of Museums 1985 Annual Meeting (June 11, 1985) [hereinafter cited as Address by Richard DeVino]; Address by Richard Meltzer (counsel to AAM on all tax matters), The 1984 Tax Act: Its Ramifications and Requirements for Museums, American Association of Museums 1985 Annual Meeting (June 11, 1985) [hereinafter cited as Address by Richard Meltzer].

101. A “qualified appraiser” means an appraiser qualified to appraise the type of property donated who is not the taxpayer, a party to the transaction through which the taxpayer acquired the property, the donee, any person employed by any of the foregoing persons, or any person whose relationship to the taxpayer would raise a question of the appraiser's independence. Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 155, 98 Stat. 692 (1984); Address by Donald R. Speiller, *supra* note 100.

102. An “appraisal summary” must include: the name and taxpayer identification number of the donor; a brief description of the contributed property and its physical condition; a description of the manner of acquisition (or if the property was created by the donor, a statement to that effect), and the date; the cost or basis of the property; the names, addresses, and taxpayer identification numbers of the donee and the appraiser; the date the donee received the property; the appraised fair market value of the property; a declaration of the appraiser's qualifications; and a declaration by the appraiser that the fee charged was proper and that he is not being penalized for previous invalid or overvalued appraisals. AAM Guide, *supra* note 2, at 10; Temp. Treas. Reg. § 1.170A-13T(c)(4) (1984); Address by Donald R. Speiller, *supra* note 100.

103. Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 155, 98 Stat. 691 (1985).

104. Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 691 (Legislative History), *reprinted in* 1984 U.S. CODE CONG. & AD. NEWS 1684.

105. AAM Guide, *supra* note 2, at 9.

106. *See supra* note 103.

- (2) quoted prices in dealers' catalogs of the artist's works (or the works of other artists of comparable stature);
- (3) the economic state-of-the-art market at or around the time of valuation, particularly with respect to the specific property;
- (4) a record of any exhibitions at which the particular art object has been displayed; and,
- (5) a statement as to the standing of the artist in his profession in the particular school or time period.¹⁰⁷

Finally, an appraisal summary (a summary of a qualified appraisal) is required by the Service.¹⁰⁸ In order for a donor to receive a charitable deduction, the appraisal summary must be submitted during the taxable year. No carryforward of a deduction into subsequent years is available.¹⁰⁹ The actual qualified appraisal is not given to the museum or sent to the Service; it functions as backup proof. The regulations do not even require that it be obtained at the time of the contribution; the appraisal need only be made before the filing of that year's tax return.¹¹⁰ However, the appraisal summary must be signed by the required parties and attached to the return, and must be given to the donee museum. The donee museum must file a follow-up form if there is any disposition of the donated property within two years from the time it was received.¹¹¹

Perhaps most important in discouraging overvaluation, the new regulations impose harsher penalties on the failure to value donations properly or to comply with the various provisions of the appraisal process.¹¹² Section 6659 of the IRC states that if the Service finds that donated property is overvalued by 150 percent or more of what is determined to be its correct value, a flat penalty of thirty percent (raised from the previous ten percent) will be applied to the total underpayment of tax that resulted from the overvaluation.¹¹³ Interest on the penalty will also be due. The Service can waive this penalty only if the donor claimed the value based on a qualified appraisal made by a qualified appraiser, and only if the donor made a good faith effort to arrive at the value.¹¹⁴

Any appraiser who falsely or fraudulently overstates the value of the property described in the appraisal, or who aids or assists in the understatement of tax will be subject to disciplinary action by the Service in addition to a civil penalty (for negligence or fraud). Additionally, the appraiser may have future appraisals disregarded.¹¹⁵

Therefore, the Internal Revenue Service and Congress seem to have squarely dealt with the problem of overvaluation and fraudulent or inaccurate appraisals. There

107. Janata, *supra* note 19, at § 57.18 (quoting Revenue Procedure 66-49, 1966-2 C.B. 1257).

108. *See supra* note 102.

109. AAM GUIDE, *supra* note 2, at 10.

110. Address by Donald R. Speiller, *supra* note 100.

111. Address by Donald R. Speiller, *supra* note 100.

112. *See supra* note 9.

113. I.R.C. § 6659 (1986); AAM GUIDE, *supra* note 2, at 11.

114. AAM GUIDE, *supra* note 2, at 11.

115. *Id.* at 11; Deficit Reduction Act of 1984, Pub. L. No. 98-369 (Legislative History), 1984 U.S. CODE CONG. & AD. NEWS (98 Stat. 695) 1687.

was no need to change the law. The Art Advisory Panel polices overvaluation for the Service, while the new laws concerning a tightening of the requirements for appraisals and appraisers are specific and sufficiently strict.

III. CHANGING THE TREATMENT OF THE CHARITABLE DEDUCTION—ITS DETRIMENTAL IMPACT ON MUSEUMS AND CHARITABLE GIVING

Although prior law worked effectively to combat overvaluation, the new comprehensive tax reform bill includes changes in the treatment of the charitable deduction. Proponents of the new tax law appear to believe that overvaluation or any other possible abuse will be adequately discouraged by repealing the nonitemizer charitable deduction and by subjecting appreciated gifts to charities to the alternative minimum tax. In fact, however, these two changes will adversely affect museums and other charitable organizations by destroying most of the incentive to give.

The Tax Reform Act of 1986¹¹⁶ is a modified flat tax proposal designed to meet three objectives: tax simplicity, tax fairness, and economic growth.¹¹⁷ These goals are to be achieved through the repeal or significant limitation of sixty to seventy different tax deductions. The revenue saved will be, in effect, distributed to the general taxpaying public in the form of lower tax rates.¹¹⁸ Under this general concept, the tax base is broadened, rates come down, the package is (hopefully) revenue neutral, and tax savings result for most taxpayers.¹¹⁹

The charitable deduction, though not repealed, was altered. As President Reagan said in his formal proposal to Congress, certain deductions were to be retained because they are associated with traditional American values, such as the deduction of interest on home mortgages, preferential treatment of Social Security and veterans' disability payments, and the charitable deduction.¹²⁰

Eighty-six percent of adult Americans gave away two percent of their personal income to charitable organizations last year, equaling \$61.5 billion; this is more than the gross national product of eighty-six countries.¹²¹ The new law is estimated to deprive nonprofit organizations of anywhere from \$5.5 to \$11.2 billion.¹²² The Tax Reform Act of 1986 will raise the cost of giving in two ways: by lowering the number of taxpayers who itemize, and by taxing the amount of appreciation on gifts of appreciated property.

116. *Tax Reform Bill of 1986*, *supra* note 10.

117. *See supra* note 11.

118. Address by Richard DeVino, *supra* note 100.

119. Address by Richard DeVino, *supra* note 100.

120. The President's Tax Proposals to the Congress for Fairness, Growth, and Simplicity 4 (May 1985)(for sale by the Superintendent of Documents, U.S. Government Printing Office, stock no. 048-000-00373-7) [hereinafter cited as *The President's Tax Proposals*].

121. *THE ECONOMIST*, June 1, 1985, as quoted by Bruce R. Hopkins, *supra* note 42.

122. Administration Proposal for Appreciation as a Tax Preference is Harmful to Charitable Purposes and Not Necessary to an Effective, Fair Minimum Tax, Statement of the American Association of Museums in response to the President's Tax Reform Proposal (1985) (available from the American Association of Museums) [hereinafter cited as *Administration Proposal*]; *Charities Find Support to Preserve Deductions*, CONG. Q. 1374 (July 13, 1985); Address by Bruce R. Hopkins, *supra* note 42.

Congress decided to conduct an experiment in 1981 when it allowed nonitemizers to deduct percentages of their charitable contributions. Five years later, although the allowance might not be deemed successful in generating revenue, the nonitemizer charitable deduction continues to have great merit and was worthy of retention, as it receives praise from museums and other charitable organizations. The deduction helped create habits of giving among younger and lower-income taxpayers, which are crucial to the future of museums and all charitable organizations.

A. Expiration of the Charitable Deduction for Nonitemizers

Prior to 1981, individuals who did not itemize their deductions could not deduct their charitable contributions;¹²³ they bore the full cost of their giving—"each dollar donated to charity reduced their after-tax income by a dollar."¹²⁴ Then, the Economic Recovery Tax Act of 1981 ("ERTA")¹²⁵ extended the charitable contribution deduction to nonitemizers, phased in over a five-year period.¹²⁶ Only one-third of all taxpayers itemize, and each time there is a tax reform bill that limits itemizing, that base shrinks and the charitable deduction becomes more vulnerable—because, as a consequence, fewer taxpayers are in a high enough tax bracket for which itemizing deductions proves worthwhile. An overwhelming majority (some sixty-five percent in 1982) do not itemize their deductions.¹²⁷

According to recent economic studies, low and middle-income households (most of the nonitemizers) are quite sensitive to the after-tax cost of giving.¹²⁸ These economic studies found that "itemizers contribute substantially more than nonitemizers at the same income level (more than twice as much for income below \$30,000), and that extending the deduction to nonitemizers would probably increase charitable contributions by more than double the resulting drop in tax revenue."¹²⁹

In an attempt to "democratize" the charitable deduction, Congress created a deduction for those taxpayers who do not itemize, giving them the incentive and the opportunity to give to the charity of their choice and have the benefit of taking at least a modified charitable deduction.¹³⁰ Even a person who takes the "standard

123. I.R.C. § 62 (1986).

124. Wiedenbeck, *supra* note 1, at 131.

125. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 121, 95 Stat. 196 (1981).

126. I.R.C. § 170(i) (1986); see The President's Tax Proposals, *supra* note 120, at 70. Specifically, for contributions made in the 1984 tax year, individuals who did not itemize deductions were permitted to deduct 25% of the first \$300 of contributions made. For 1985 and 1986, the \$300 limitation is removed, and the percentage of contributions deductible by nonitemizers is increased to 50% and 100%, respectively. Thus, under current law, the charitable contribution deduction will be allowed in full to nonitemizers in 1986. The charitable deduction for nonitemizers is scheduled to expire after 1986, however, so that after that time the deduction will again be unavailable to individuals who do not itemize their deductions.

The President's Tax Proposals, *supra* note 120, at 70. See also Charitable Contribution Deduction for Nonitemizers, [Tax Reform Act of 1985: Report of the Committee on Ways and Means Explanation] FED. TAXES (P-H) ¶ 59,663 at 111-12 (Dec. 12, 1985).

127. Wiedenbeck, *supra* note 1, at 130-31.

128. *Id.* The charitable deduction currently is available to any taxpayer, regardless of income. But whereas a wealthier donor can make a gift to a charity with little financial difficulty, a low or middle-income taxpayer probably weighs whether or not he should put his resources to a more "practical" use.

129. *Id.* at 131 n.146.

130. Address by Bruce R. Hopkins, *supra* note 42.

deduction," or the zero bracket amount, could take a charitable deduction on top of that base amount.¹³¹ However, the deduction for nonitemizers had a built-in expiration date because Congress designed it as an experiment.¹³² The expiration date has permitted Congress to evaluate the effects of allowing the deduction to nonitemizers and judge its efficiency.

The Tax Reform Act of 1986 effectively repeals the above-the-line nonitemized deduction,¹³³ actually accelerating the original expiration date by one year to January 1, 1987.¹³⁴ Thus, the nonitemizer charitable deduction terminates for contributions made after December 31, 1986.¹³⁵ The Treasury Department put forward two tax rationales for the repeal in addition to the revenue it would generate. First, the zero bracket amount is designed to embrace, for people who do not itemize, all of the deductions they would otherwise take.¹³⁶ The Service contends that the charitable deduction is already provided for—allowing a charitable deduction on top of the zero bracket amount in effect, allows a double deduction.¹³⁷ Second, the Service believes that taxpayers are claiming small deductions for gifts they really are not making. The per donor amounts are very small, and are administratively burdensome for the Service to audit.¹³⁸

However, the charitable deduction for nonitemizers could potentially generate a great deal of revenue for nonprofit organizations. One study estimated a nonprofit revenue gain for the nonitemizer deduction in the neighborhood of \$6 billion a year, once the provision was fully phased in.¹³⁹

1. *Benefits of Retaining the Nonitemizer Deduction*

In the past, the problem with the above-the-line deductions has been that most large charitable organizations and institutions have not paid much attention to them—they believe their donors itemize, and that those donors who do not itemize do not give enough to make any kind of appeal on their behalf worthwhile. This view is fairly legitimate because itemizers encompass the most well-to-do of the taxpayers, making the vast majority of gifts. "Lower income taxpayers typically make most of

131. See I.R.C. §§ 62, 63, 170(i) (1986).

132. The President's Tax Proposals, *supra* note 120, at 70; Wiedenbeck, *supra* note 1, at 131.

133. See I.R.C. §§ 62, 170(i) (1986).

In a very broad sense all deductions are from gross income and result in taxable income. However, in the statutory scheme, some items of deduction are spoken of as allowable "above the line" (those described in Section 62), while some are deductible "below the line" (those outside Section 62). In this regard, Section 62 does not *authorize* any deduction. It simply *identifies* deductions, authorized elsewhere in the statute, which may be taken in arriving at adjusted gross income Deductions described in Section 62 are allowed in their entirety . . . and in this light they are especially favorable deductions.

J. FREELAND, S. LIND & R. STEPHENS, *supra* note 31, at 536-37.

134. The President's Tax Proposals, *supra* note 120, at 71. The House voted to change the date upon which the various amendments would take effect from January 1, 1986, to January 1, 1987. *House Passes Ways and Means Bill*, 29 TAX NOTES 1197, (Dec. 23, 1985).

135. PRENTICE-HALL'S EXPLANATION OF THE TAX REFORM ACT OF 1986 12 (1986); [*Tax Reform Bill of 1986 (H.R. 3838): Statement of the Managers* filed Sept. 18, 1986—Part II] 73 STAND. FED. TAX REP. (CCH) II-21 (Sept. 21, 1986).

136. Address by Bruce R. Hopkins, *supra* note 42.

137. The President's Tax Proposals, *supra* note 120, at 70; see Address by Bruce R. Hopkins, *supra* note 42.

138. The President's Tax Proposals, *supra* note 120, at 70; see Address by Bruce R. Hopkins, *supra* note 42.

139. Brannon & Ahmann, *Charitable Contributions and Nonitemizers*, 29 TAX NOTES 1078 (Dec. 9, 1985).

their charitable contributions to religious and community service organizations such as churches and the United Way."¹⁴⁰ These organizations have most likely received the most direct and immediate benefit from the current deduction for nonitemizers; yet, in the long run, all charities would gain.¹⁴¹ The effect of allowing a deduction for nonitemizers would be to broaden the base of philanthropy and to encourage development of habitual charitable giving.¹⁴² Younger taxpayers, who generally have lower incomes and do not itemize,¹⁴³ would become accustomed to giving to charities because they would have the incentive of receiving a deduction. In time, such individuals could become substantial contributors—the deduction for nonitemizers would provide the base upon which a habit of giving is formed.¹⁴⁴ However, a great deal of opposition existed regarding retention of the experimental deduction.

2. Problems with the Expiration of the Nonitemizer Deduction

By repealing nearly all other tax deductions and credits, the Tax Reform Act of 1986 will aggressively accelerate the trend toward nonitemization (partly because there will be only two tax rates instead of fourteen: fifteen percent and twenty-eight percent),¹⁴⁵ with rather staggering effects—eighty-five percent of taxpayers will cease to be itemizers and the base of tax deducting donors will shrink dramatically to fifteen percent.¹⁴⁶ In other words, more taxpayers will be shifted into a lower income bracket, where they will become nonitemizers. In its attempts at simplification, the Tax Reform Act will extend the movement away from itemizing until nearly seventy-five percent of all taxpayers probably will be able to use the short form.¹⁴⁷ This could have severe effects on charitable organizations: "Thirty-eight percent of charitable gifts come from those with incomes below \$20,000. Eighty-five percent of gifts come from those with incomes below \$50,000. Such a shift to the standard deduction without an above-the-line contribution deduction would result in a very significant loss of income for nonprofit organizations."¹⁴⁸

Independent Sector, a coalition of over 600 charitable groups based in Washington, D.C. that has aggressively lobbied for the above-the-line deduction, calculated that the repeal of the charitable deduction for nonitemizers will decrease annual giving by about \$5.5 billion.¹⁴⁹ Even the wealthier donors will be affected. Under the previous system, ninety-three percent of taxpayers with incomes between \$75,000 and \$100,000 were itemizers.¹⁵⁰ Ninety-seven percent of taxpayers in the

140. Wiedenbeck, *supra* note 1, at 131.

141. *Id.*

142. *Id.*

143. *Id.*

144. *Id.*

145. Starting in 1988, the Tax Reform Act will also impose a 5% surtax on income between \$71,900 and \$149,250 (\$43,150 and \$89,560 for singles). This surtax is intended to phase out any benefit received by high-income taxpayers from the 15% bracket. PRENTICE-HALL'S EXPLANATION OF THE TAX REFORM ACT OF 1986 ¶ 11 (1986).

146. Address by Bruce R. Hopkins, *supra* note 42.

147. Brannon & Ahmann, *supra* note 139, at 1079.

148. *Id.*

149. See *supra* note 122.

150. Address by Bruce R. Hopkins, *supra* note 42.

\$100,000 to \$200,000 bracket itemized.¹⁵¹ The above-the-line deduction is not as critical to a large museum, university, college, or hospital as it would be to a small community organization (e.g., a small gallery or historical society). But the repercussions of eliminating the nonitemizer deduction will eventually be felt by even the wealthiest charities.¹⁵²

It is estimated that under the new tax law, the percentage of taxpayers in the \$75,000 to \$100,000 income bracket who itemize will fall from ninety-three to sixty-two percent; the percentage of itemizing taxpayers in the \$100,000 to \$200,000 range will fall from ninety-seven to seventy percent.¹⁵³ Over one-half of taxpayers with income between \$30,000 and \$50,000 will become nonitemizers almost automatically, as they are moved to a lower income bracket.¹⁵⁴ In short, there will be a dramatic shift of taxpayers to the nonitemizing category, making the retention of the above-the-line deduction more important (and perhaps even vital) to all charities and philanthropies. The House Ways and Means Committee recognized the problem. As noted by one commentator: "[T]here is a good deal of evidence, and there are credible arguments which justify extending the charitable deduction to nonitemizers permanently. I am happy to note that the Ways and Means Committee did just that when its recently reported tax bill included such a provision."¹⁵⁵

When the House of Representatives passed "Treasury II" (the President's Tax Reform Proposal)¹⁵⁶ in December, 1985, the Ways and Means Committee provided for permanent extension of the charitable deduction to nonitemizers. However, the Senate did not agree on the value of retaining the provision. Similarly, the Senate reviewed the proposal to add charitable gifts of appreciated property to the list of tax preference items subject to the alternative minimum tax. This change in the alternative minimum tax will have the greatest effect on charitable giving. The provision in the new law concerning gifts of appreciated property will take away the specific tax incentive created by Congress for the purpose of encouraging charitable giving.

B. Revision of the Alternative Minimum Tax—Destroying Incentive to Give

On several past occasions, Congress has considered proposals that would limit the deductibility of appreciated property gifts to charities, contending that all deductible unrealized gain should be subject to the alternative minimum tax—now a twenty-one percent tax imposed on taxpayers who use tax preferences to substantially

151. *Id.*

152. *See supra* notes 140–46 and accompanying text.

153. Address by Bruce R. Hopkins, *supra* note 42 (quoting research at Harvard for Independent Sector); *see supra* note 122 and accompanying text.

154. *Id.*

155. Brannon & Ahmann, *supra* note 139, at 1079; Charitable Deduction for Individuals Who do not Itemize Made Permanent [*Tax Reform Act of 1985: Text of Committee on Ways and Means Bill*] § 133 FED. TAXES (P-H) ¶ 59,661 at 55 (Dec. 6, 1985).

156. The President's Tax Proposals, *supra* note 120.

reduce their regular taxes.¹⁵⁷ At least equally and perhaps even more significant in impact upon charitable organizations than the repeal of a deduction for nonitemizers are the implications of the provision in the Tax Reform Act of 1986 which adds gifts of appreciated property to charitable organizations to the list of tax preference items subject to the alternative minimum tax.¹⁵⁸ According to the general explanation in chapter 13.03 of Treasury II, "the alternative and corporate minimum taxes were originally enacted as part of the Tax Reform Act of 1969 to ensure that 'all taxpayers are required to pay significant amounts of tax on their economic income.'"¹⁵⁹ The measures were considered necessary because, as Congress concluded, "many individuals and corporations did not pay tax on a substantial part of their economic income as a result of the receipt of various kinds of tax-favored income or special deductions."¹⁶⁰ As a result, the current alternative minimum tax was enacted.

1. *Prior and Newly-Enacted Law Concerning the Alternative Minimum Tax*

An alternative minimum tax ("AMT") already exists under IRC section 55.¹⁶¹ Noncorporate taxpayers whose regular tax liabilities are substantially reduced by tax preferences are, in effect, subject to the AMT in lieu of the regular income tax. Under section 55, the AMT is equal to twenty percent of the excess of the taxpayer's "alternative minimum taxable income" ("AMTI") over an exemption amount.¹⁶² This excess is actually imposed in addition to the regular tax. A taxpayer's AMTI is computed by "(a) adding tax preferences back to adjusted gross income, (b) subtracting the 'alternative tax itemized deductions,' and (c) making adjustments for net operating loss carryovers and certain trust distributions included in income under the so-called 'throwback rules.'"¹⁶³ The alternative tax itemized deductions include:

157. In 1968, 1969, and again in 1974, the Treasury Department proposed that deductible unrealized appreciation on charitable contributions should be subject to a minimum tax. STAFF OF THE JOINT COMM. ON INT. REV. TAX., 94TH CONG., 1ST SESS., CHANGES IN THE MINIMUM TAX AND LIMITS ON ITEMIZED DEDUCTIONS 3-4, 8-10 (Comm. Print 1975); Wiedenbeck, *supra* note 1, at 136. See also *Tax Reform Bill of 1986*, *supra* note 10, at I-249 (§701).

158. The tax adjustment and preference items that are added to the adjusted gross income basis for purposes of the alternative minimum tax on individuals are:

(a) depreciation, (b) pollution control facilities, (c) completed contract method, (d) percentage depletion, (e) intangible drilling costs, (f) installment sales of dealer property, (g) mining exploration and development costs, (h) circulation expenditures, (i) research and experimentation expenditures, (j) tax exempt interest on nonessential function bonds, (k) charitable contributions of appreciated property, (l) incentive stock options, (m) passive farm losses, and (n) passive activity losses.

PRENTICE-HALL'S EXPLANATION OF THE TAX REFORM ACT OF 1986 702-09 (§§702-16) (1986).

159. The President's Tax Proposals, *supra* note 120, at 329. The Ways and Means Committee believes that the minimum tax should serve one overriding objective: to ensure that no taxpayer with substantial economic income can avoid significant tax liability by using exclusions, deductions, and credit. [*Tax Reform Act of 1985: Report of the Comm. on Ways and Means*] FED. TAXES (P-H) ¶ 59,663 at 305-06 (Dec. 12, 1985).

160. *Id.* at 329-30.

161. I.R.C. § 55(a) and (b) (1986) provide:

In the case of a taxpayer other than a corporation, there is imposed . . . a tax equal to the excess (if any) of—

(1) an amount equal to 20 percent of so much of the alternative minimum taxable income as exceeds the exemption amount over (2) the regular tax for the taxable year.

In addition, section 55 defines the alternative minimum taxable income as "the adjusted gross income . . . of the taxpayer for the taxable year—(1) reduced by the sum of—(a) the alternative tax net operating loss deduction, plus (b) the alternative tax itemized deductions, plus (c) any amount included in income under section 87 or 667, and (2) increased by the amount of items of tax preference."

162. The President's Tax Proposals, *supra* note 120, at 328.

163. *Id.*

“(a) casualty losses and certain wagering losses, (b) *charitable contributions*, (c) deductible medical expenses, (d) certain interest expenses (including interest on debt incurred to acquire the taxpayer’s principal residence), and (e) estate taxes attributable to income in respect of a decedent.”¹⁶⁴ The exemption amount for the AMT is: “(a) \$40,000 for a joint return or a surviving spouse, (b) \$30,000 for a single taxpayer or head of household, and (c) \$20,000 for other noncorporate taxpayers.”¹⁶⁵

Under the Tax Reform Act of 1986, the structure for determining the alternative minimum tax on individuals generally will remain the same as under prior law. However, the threshold exemption amounts will be reduced by twenty-five percent of the alternative minimum taxable income in excess of “(1) \$150,000 for joint returns; (2) \$75,000 for married taxpayers filing separately and for trusts; and (3) \$112,500 for single taxpayers.”¹⁶⁶ In addition, the new law will increase the rate of the AMT to twenty-one percent for a taxpayer other than a corporation.¹⁶⁷

Under the Tax Reform Act of 1986, there is a new addition to the AMT tax preference items—a capital gain element generated by the contribution of appreciated property to a charity.¹⁶⁸ Even though donors will get the full fair market value deduction for a gift of property, donors will have to take into their calculation of the AMT that portion of the deduction that represents the appreciation in value.¹⁶⁹ This will unquestionably be a substantial disincentive to those who give the largest gifts to museums and other charitable organizations because these gifts usually would have appreciated the most, and therefore would require payment of substantially higher taxes. Supposedly, as with previous proposals,¹⁷⁰ “[t]he proposal [will] minimize the number of high-income individuals who pay little or no tax as a result of heavy utilization of the tax preferences included in the alternative minimum tax base, and [will] thus improve the fairness of the tax system.”¹⁷¹ More than likely, only individuals using substantial amounts of tax preferences (the vast majority of donors of works of art) would need to compute the minimum tax. However, regardless of a feeling that wealthier individuals should pay a higher tax, the future of museums will be seriously impaired because gifts of appreciated property are now subject to the alternative minimum tax.

2. Rationales for Rejecting Changes to the Alternative Minimum Tax

Though the American Association of Museums (“AAM”) is unquestionably an interested party, its recommendation for continuing the prior law advances significant

164. *Id.* (emphasis added).

165. *Id.* [Tax Reform Bill of 1986 (H.R. 3838): *Statement of the Managers filed Sept. 18, 1986—Part II*] 73 STAND. FED. TAX REP. (CCH) II-250 (Sept. 21, 1986).

166. PRENTICE-HALL’S EXPLANATION OF THE TAX REFORM ACT OF 1986 § 701 (1986); SENATE FINANCE COMM., TAX REFORM ACT OF 1986, S. REP. NO. 313, 99th Cong., 2d Sess. 522 (1986).

167. *Tax Reform Bill of 1986*, *supra* note 10, at I-249 (§701).

168. *Tax Reform Bill of 1986*, *supra* note 10, at I-264 (§701).

169. Address by Bruce R. Hopkins, *supra* note 42; The President’s Tax Proposals, *supra* note 120, at 331(k); PRENTICE-HALL’S EXPLANATION OF THE TAX REFORM ACT OF 1986 708 (§ 712)(1986); [Tax Reform Bill of 1986 (H.R. 3838): *Statement of Managers filed Sept. 18, 1986—Part II*] 73 STAND. FED. TAX REP. (CCH) II-259 (Sept. 21, 1986).

170. See *supra* note 157 and accompanying text.

171. SENATE FINANCE COMM., TAX REFORM ACT OF 1986, S. REP. NO. 313, 99th Cong., 2d Sess. 518–19 (1986).

and credible rationales, stressing the importance of maintaining incentives for charitable giving to museums. The AAM asserts that making appreciated property a tax preference item will prove harmful to charitable interests and is not necessary to an effective, fair minimum tax.¹⁷² These proposals should be given weight, as they point out why appreciation does not fit appropriately under the AMT, and they offer the best reasons for returning to the previous treatment of the charitable deduction.

Pointing out that the comprehensive tax proposal will cost charities (and the public purposes served) an estimated \$11.2 billion in 1986 giving,¹⁷³ the AAM's first argument is that charitable giving is not a true tax shelter since by law it must serve public purposes and is a voluntary shifting of dollars from personal to public use.¹⁷⁴ Second, the AAM points out that gifts of appreciated property are leadership gifts and thus critical to major fund-raising by all public charities.¹⁷⁵ Third, appreciated property gifts really do not create the problem at which the AMT is aimed—no taxpayer can “zero out” (or have enough deductions so that he does not owe any tax) by such gifts alone.¹⁷⁶ Deductibility of gifts of appreciated property was already limited to thirty percent of adjusted gross income per year, and a recent Treasury report stated that itemized deductions (e.g., charitable, medical, casualty, home mortgage interest) are *not* important causes of high-income taxpayers “zeroing out.”¹⁷⁷

Fourth, the AAM promotes the prior treatment of the charitable deduction, especially for appreciated property gifts, as effective and efficient: “the preponderance of evidence suggests that the itemized charitable deduction has been a stimulant to charitable giving, at least for higher-income individuals.”¹⁷⁸ Such individuals tend to make the most appreciated property gifts, and the easier it is for higher-income individuals to take a charitable deduction, the more likely they are to continue giving.

Fifth, the former deduction for appreciated property gifts seemed quite “fair,” according to the AAM's proposals.¹⁷⁹ As indicated by the AAM, high-income taxpayers will tend to keep their assets rather than donate them now that appreciated property rules actually have been changed, thus reducing private support for public purposes.¹⁸⁰ Sixth, the AAM estimates that eliminating the deduction will cost charities \$935 million in 1986 giving, but will raise only \$645 million in revenue.¹⁸¹ Finally, the AAM asserts that continuing prior law would have removed only seven

172. See Administration Proposal, *supra* note 122.

173. “\$3.9 billion is the indirect effect of lowered rates and other changes, exclusive of any changes in the current charitable deduction. \$6.4 billion is the effect in 1986 of eliminating the charitable deduction for nonitemizers. \$935 million is the effect of including appreciation as an item of tax preference in the AMT.” *Id.*

174. *Id.*

175. *Id.*

176. *Id.*

177. *Id.*

178. *Id.*

179. “The taxpayer is always worse-off after-tax, after-gift, than if he did not make the gift or than if he sold the asset and paid the capital gains tax.” *Id.* at 2.

180. *Id.*

181. *Id.*

percent of affected taxpayers from the proposed AMT and all of them would pay significant regular income taxes.¹⁸² The recommendation appropriately concludes that appreciation should not have been made an item of tax preference because the prior law "is more efficient than would be the tax law without deductibility in efficiently and fairly shifting resources from private to public uses, and better reflects the fundamental nature and values of American society."¹⁸³ The AAM strongly believes that the former law should have been maintained, recognizing the problems likely to be caused by changing the treatment of the appreciated charitable deduction.

3. *Probable Results of Enacting this Provision of the Tax Reform Act of 1986*

Museums must recognize that those donors close to the point at which the alternative minimum tax will be triggered are going to cut down on expenditures that will cause them to face the undesirable twenty-one percent AMT tax rate. According to a study conducted by Lawrence Lindsey of Harvard University, approximately sixty-five percent of the total value of all gifts of appreciated property by taxpayers with adjusted gross income in excess of \$100,000 are made by taxpayers who will be subject to the alternative minimum tax.¹⁸⁴ The alternative minimum tax will increase the cost of giving for these people, reducing their incentive to make contributions. If these assumptions are correct, then fully two-thirds of gifts which would otherwise be received by museums and other cultural institutions will be lost.¹⁸⁵

Fourteen preference items are included under the new alternative minimum tax provision of the Tax Reform Act¹⁸⁶—the targeted group of taxpayers will have a difficult time avoiding them. Charitable giving will be especially vulnerable because it is one of the few items of tax preference that is wholly discretionary to the taxpayer.

Museums could help donors avoid the alternative minimum tax (perhaps by suggesting contributions of cash in lieu of part of a collection they were planning to donate), but it is quite likely that donors will back off on making contributions altogether. The new tax law will not have any impact on percentage limitations—an individual will still be able to donate to museums and take a deduction for gifts of cash up to fifty percent of adjusted gross income and for gifts of appreciated property up to thirty percent, and in both cases get a five-year carryforward under section 170.¹⁸⁷ But, with respect to the total proportion of gifts made by one-third of all taxpayers, "the losses will be incredible."¹⁸⁸

A gift of appreciated property is fundamentally different from the other types of activities that fall under the alternative minimum tax. A charitable contribution of an artist's work is quite different from an exploitation of accelerated deductions in business transactions, or from a creation of a current tax benefit that is intended to

182. *Id.*

183. *Id.*

184. Address by Bruce R. Hopkins, *supra* note 42.

185. Macomber, *supra* note 2, at 4; Address by Richard Meltzer, *supra* note 100.

186. *See supra* note 158.

187. *See* I.R.C. § 170(b)(1)(A) and (B) and (d)(1) (1986).

188. Address by Bruce R. Hopkins, *supra* note 42.

lead to a future economic benefit.¹⁸⁹ A charitable contribution of appreciated property is a "permanent, non-recoverable disposition that irrevocably reduces the donor's net worth."¹⁹⁰ No other single element of the tax system produces so large a ratio of public benefit to private advantage.¹⁹¹

The consequences of changing the charitable deduction could prove staggering. "A massive reduction in contributions would force charitable organizations to begin charging admission or to increase prices."¹⁹² Tuition at universities and admission charges to theaters, concerts, and museums could increase sharply.¹⁹³ "Services currently provided by charitable organizations that are in the nature of 'public goods' (below-cost services that may be utilized by many people without regard to whether they have contributed to the institution) might become available only to those who could afford to pay a price reflecting the full cost of providing such services."¹⁹⁴

An examination of the prior law and the most probable results of the Tax Reform Act's changes shows the necessity of retaining the charitable deduction for nonitemizers, and for rejecting the addition of appreciated gifts of property to charities to the list of tax preference items subject to the alternative minimum tax. The prior law, with its built-in safeguards under section 170 and its appropriate restrictions created under the 1984 Deficit Reduction Act, was sufficiently equipped to effectively handle problems in appraising and overvaluation of gifts. Though revenue may be increased by the Tax Reform Act's treatment of unrealized appreciation on gifts, it does not justify the adverse effects the proposal will have upon charitable giving. The charitable deduction as it stood created incentive to give; it did not eliminate the loss to the donor when he made a gift.

IV. CONCLUSION

Section 170 of the Internal Revenue Code, the Art Advisory Panel, and relevant provisions of the Tax Reform Act of 1984 work together to insure that museums will maintain adequate collections, that the incentive to give is preserved, and that any possible overvaluation problems are remedied. The provisions of the Tax Reform Act of 1986 changing the charitable deduction will prove to be a substantial disincentive to donating to museums. The repeal of the deduction for nonitemizers will decrease the donor base, and the addition of gifts of appreciated property to charitable organizations to the list of tax preference items subject to the alternative minimum tax will dissuade those individuals who give the most to museums. The prior law was sound and effective, and should have been maintained.

According to William Macomber, president of the Metropolitan Museum of Art, "a charitable contribution to a museum is an act of private investment in a public

189. Macomber, *supra* note 2, at 7.

190. *Id.*

191. *Id.* at 8.

192. Wiedenbeck, *supra* note 1, at 93.

193. *Id.* at 94.

194. *Id.*

purpose, in which the return is not to the donor, but to the public.”¹⁹⁵ This concept should be kept in mind during any discussion of tax reform, for even though the desire to give to worthy causes is inherent in the American character, the tax laws definitely affect how much is given. A basic element of tax policy is the removal of obstacles to growth in order to promote “innovation and achievement.”¹⁹⁶ But if charitable organizations are so burdened as to be unable to reflect the innovations and achievements of a more steady economy as they are seen illustrated in works of art, then our society is truly being taxed.

*Susan E. Wagner**

195. Macomber, *supra* note 2, at 8.

196. The President's Tax Proposals, *supra* note 120, President Reagan's statement to the Congress.

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